BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOI IN I'. AND NINA J. DAVIS)

For Appellants: John P. Davis, in pro. per.

For Respondent: James W. Hamiltdn
Acting Chief Counsel

Steven S. Bronson
Counsel

OPINION

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of John P. and Nina J. Davis for refund of personal income tax in the amount of $1,760.42 for the year 1973.

The sole issue for consideration is whether the residency requirements of California's income averaging provisions violate the privileges and immunities clause of the United States Constitution.

Appellants were California residents from 1964 through 1972 and filed resident California personal income tax returns for those years, For 1.973, they filed a joint nonresident return which indicated they were residents of Carson City, Nevada. During 1974, appellants filed a claim for refund with respondent for the amount of tax they allegedly would have saved had they been permitted the use of income averaging on their 1973 nonresident return. Respondent denied the claim for refund and this timely appeal followed.

California's income averaging provisions are contained in sections 18241. through 18246 of the Revenue and Taxation Code. The residency requirements are found in section 18243, which provides in part:

> (a) Except as otherwise provided in this section, for purposes of this article the term "eligible individual" means any individual who is a resident of this state throughout the computation year.
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> (b) For purposes of this article an individual shall not be an eligible individual for the computation year if, at any time during such year or the base period, such individual was a nonresident.

The term "computation year" means the taxable year for which the taxpayer chooses the benefit of income averaging and the term "base period" is defined as the four taxable years immediately preceding the computation year. (Rev. & Tax. Code, § 18242, subd. (d).)

Since appellants were nonresidents during the computation year 1973, section 18243 expressly prevented them from using the income averaging method. They, nevertheless, assert eligibility to average their income for 1973 on the ground that California's residency provisions are unconstitutional and, therefore, void. Specifically, appellants allege that these residency provisions infringe the rights guaranteed them in article IV, section 2, clause (1) of the United States Constitution, which states:

> The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several. States.

The general test of a statute's constitutionality under the Privileges and Immunities Clause was stated in the case of Toomer v. Witsell, 334 U. S. 385 [92 L. Ed. 1460] where the Supreme Court said:

> Like many other constitutional provisions, the privileges and immunities clause is not an absolute. It does bar discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other States. But it does not preclude disparity of treatment in the many situations where there are perfectly valid independent reasons for it. Thus the inquiry in each case must be concerned with whether such reasons do exist and whether the degree of discrimination bears a close relation. to them (footnote omitted). The inquiry must also, of course, be conducted with due regard for the principle that the States should have considerable leeway in analyzing local evils and in prescribing appropriate cures. (334 U. S. at 396.)

Appellants' position is based primarily on the holding of the Supreme Court in Travis v. Yale & Towne Mfg. Co. , 252 U. S. 60 [64 L. Ed. 460]. That case struck down as unconstitutional a New York income tax statute which granted exemptions to residents but not to nonresidents. The Court determined that the actual effect of the discrimination was to severely disadvantage nonresidents working in New York City by making them compete with residents for wages, salaries, and other terms of employment on an unequal basis. In reaching its conclusion the Court stated:

> [A] general taxing scheme such as the one under consideration, if it discriminates against all non-residents, has the necessary effect of including in the discrimination those who are citizens of other states; and if there be no reasonable ground for the

> diversity of treatment, it abridges the privileges and immunities to which such citizens are entitled. (252 U. S. at 79.) (Emphasis added.)

In Shaffer v. Carter, 252 U. S. 37 [64 L. Ed. 445], decided by the Court on the same day as Travis, the Court upheld an Oklahoma income tax statute which imposed a tax upon the net income received by a nonresident from property owned and business carried on within Oklahoma. The Court examined the impact of the tax and found it to be no more onerous in effect than the similar tax Oklahoma residents were required to pay. In upholding the Oklahoma statute, the Court in Shaffer pointed out that although a nonresident is entitled to the privileges and immunities of the citizens of a state he enters, he is not entitled to any preferential treatment as compared with resident citizens of that state. (252 U. S. at 53.)

In our view the residency requirements in question, unlike the residency requirements considered in Travis, are based on reasonable grounds which justify diversity of treatment; and, in effect, are no more onerous upon foreign citizens who are nonresidents than upon similarly situated California citizens. (See Shaffer v. Carter, supra.)

Since California's income averaging law was modeled on similar federal provisions (See Int. Rev. Code of 1954, §§ 1301-1305) the federal legislative purpose is pertinent in determining the California Legislature's -purpose in enacting nearly identical statutes. (See Appeals of Diamond Gardner Corp., etc. , Cal. St. Bd. of Equal. , Feb. 5, 1963; Appeal of Laurence E. Broniwitz, Cal. St. Bd. of Equal., Sept.. 10, 1969.)

Federal legislative intent relative to the general reasons for enactment of income averaging legislation has been explained as follows:

> A general averaging provision is needed to accord those whose incomes which fluctuate widely from year to year the same treatment accorded those with relatively stable incomes. Because the individual income tax rates are progressive, over a period of years those whose incomes vary widely from

> year to year pay substantially more in income taxes than others with a comparable amount of total income but spread evenly over the years involved. This occurs because the progressive rates take a much larger proportion of the income in taxes from those whose incomes in some years are relatively high. ...
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> Income averaging in your committee's view, should be designed to treat everyone as nearly equally for tax purposes as possible, without regard to how their income is spread over a period of years and without regard to the type of income involved. At the same time, it is necessary to have any income averaging device in a form which is workable, both from the standpoint of the taxpayer and the Internal Revenue Service. (H. R. Rep, No. 749, 88th Cong., 1st Sess. (1963) [Vol. 1, 1964 U. S. Code Cong. & Ad. News pp. 1418, 1419].)

The following explanation for the federal eligibility requirements appears in the House report:

> To be eligible for averaging, one of the principal concerns is that the individual's income must have been subject to tax by the United States throughout the entire base period as well as the computation year. No one is eligible for averaging who was a nonresident alien in any of the 4 base period years or in the computation year. ....
>
> A second concern of this provision is that the individual be a member of the labor force in both the computation year and in the 4 base period years.. .. (H. R. Rep. No. 749, 88th Cong., 1st Sess. (1963) [Vol. 1, 1964 U. S. Code Cong. & Ad. News, p. 1423].)

The foregoing quotations clearly indicate that equalization of the tax burden by ameliorating the harsh effects of the progressive tax rates on taxpayers with widely fluctuating incomes was Congress' underlying purpose in enacting income averaging legislation. However, Congress was also concerned that the plan be administratively feasible; thus, it had to be "workable, both from the standpoint of the taxpayer and the Internal Revenue Service." Also, in implementing income averaging, Congress expressed dual concerns that the taxpayer seeking relief must have been subject to federal taxing jurisdiction and also a member of the labor force throughout the base and computation periods. The same purpose and concerns were reflected by the California Legislature in enacting similar provisions.

In California, residency for the requisite five years facilitates the administration of the income averaging law since the taxing authority is in a much better position to ascertain and verify pertinent facts such as income earned, marital status, support received, etc., with respect to its own residents than for nonresident individuals. Residency also insures that a taxpayer's entire income has been subject to the taxing jurisdiction throughout the base and computation periods (Rev. & Tax. Code, § 17041, subd. (a)). Such subjection promotes tax burden equalization since without it there is a good chance that a taxpayer with fluctuating income who was a nonresident during a portion of the base or computation periods would obtain a distinct advantage over a similarly situated taxpayer with stable income by paying less tax in a particular computation year based partly on periods when his income was not subject to the state's so-called harsh progressive tax rates. That such preferential treatment is not required by the constitution is obvious. (See Shaffer v. Carter, supra.) Finally, the residency requirement makes it much more likely that the taxpayer was a member of the labor force and therefore a contributor to the state's economy. (See Cal. Admin. Code, tit. 18, reg. 1.7014-17016(b).)

Facility of administration, subjection to the state's taxing jurisdiction throughout the entire base and computation periods, and membership in the state's labor force are, we believe, reasonable grounds for any discrimination resulting from the residency requirements in question. Furthermore, the effect of the discrimination is no more onerous with respect to nonresidents than residents, e.g., if any resident has been in the state for less than the full five year period he too may not use the income averaging method, On balance, California's residency requirements for income'averaging purposes are an equitable exchange for the privilege of income averaging and do not infringe upon appellants' constitutional privileges and immunities. Accordingly, we must deny appellants' claim for refund.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of John P. and Nina J. Davis for refund of personal income tax in the aniount of $1,760.42 for the year 1973, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of March, 1976, by the State Board of Equalization.

William M. Bennett, Chairman

________________, Member

George R. Reilly, Member

________________, Member

________________, Member

ATTEST: W. W. Dunlop, Executive Secretary